

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 95-0353 ST
Sales and Use Tax
For The Tax Periods: 1991, 1992, and 1993

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Use Tax: Credit for Sales Tax Paid by Another

Authority: IC 6-2.5-3-2

Taxpayer seeks use tax credit for sales tax paid on computer hardware by another.

II. Use Tax: Computer Software Agreement

Authority: IC 6-2.5-3-2, IC 6-2.5-4-1, IC 6-8.1-3-3

Taxpayer protests the assessment of sales/use tax on its computer software licensing agreement.

III. Tax Administration: Negligence Penalty

Authority: IC 6-8.1-10-2.1

Taxpayer protests the assessment of negligence penalty.

STATEMENT OF FACTS

Taxpayer is engaged in the business of providing legal counsel and services. To conduct its business, taxpayer purchased computer hardware and a computer software licensing agreement.

Additional facts will be provided as needed.

I. Use Tax: Credit for Sales Tax Paid by Another

DISCUSSION

Pursuant to IC 6-2.5-3-2, use tax is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction. Taxpayer was

assessed use tax on its purchase of a computer system consisting of hardware and software. Taxpayer seeks credit for sales tax paid on computer hardware by another. Regarding taxpayer's purchase of computer hardware, taxpayer's supplier of computer hardware purchased appropriate hardware to be installed at taxpayer's business location. Taxpayer's supplier's source shipped the hardware directly to the taxpayer. Taxpayer's supplier paid Indiana sales tax on this purchase. Taxpayer was assessed use tax for its use of the hardware, tangible personal property, acquired in a retail transaction between taxpayer and its supplier.

Taxpayer argues that the taxpayer's supplier was a purchasing agent of the taxpayer. Pursuant to taxpayer's purchase agreement with its supplier, the taxpayer purchased a computer system consisting of hardware and software. There is no language in the agreement that indicates an agency relationship exists between the taxpayer and its supplier. The purchase agreement does not indicate that the supplier is a purchasing agent for the taxpayer.

Rather, in this case, the taxpayer's supplier was a purchaser in a typical drop shipment scenario. Drop shipments involve the sale of goods by a seller who delivers the goods directly to the purchaser's customer. However, this is generally not a three-party transaction, but two two-party transactions. The first transaction is the sale from the seller (taxpayer's supplier's source) to the purchaser (taxpayer's supplier). The second transaction is the sale from the purchaser (taxpayer's supplier) to the purchaser's customer (taxpayer). In this case, there was not a transaction between the seller and the purchaser's customer. In the usual drop shipment scenario, the transaction that is subject to tax is the one between the purchaser and the purchaser's customer. Despite the taxpayer's supplier's payment of tax in the "first transaction", the "second transaction" between taxpayer's supplier and taxpayer is taxable. The transaction between the taxpayer and the supplier is a retail transaction subject to sales and use tax. Sales tax was not remitted on this transaction. Therefore, the taxpayer is liable for use tax on the purchase.

FINDING

Taxpayer's protest is denied.

II. Use Tax: Computer Software Agreement

DISCUSSION

Taxpayer protests the assessment of use tax on its purchase of a computer software licensing agreement. Taxpayer argues that the purchase of software is the purchase of a license that is not subject to tax. Taxpayer argues that the purchase is neither a sale nor lease and is therefore not taxable under Indiana statutes. Pursuant to IC 6-2.5-3-2, use tax is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. The Department has determined that software is tangible personal property subject to tax. The medium by which the property, in this case software, is transferred is irrelevant; the software is a marketable tangible product for sale. Thus, the taxpayer's purchase of software is subject to sales and use tax.

The taxpayer argues further that the Department has not followed administrative procedures to change its policy regarding the taxability of software. Citing IC 6-8.1-3-3, the taxpayer contends that the Department cannot change its interpretation of the law to the detriment of a taxpayer without first issuing a rule or regulation. The taxpayer argues the Department changed its interpretation as to the taxability of software licensing agreement purchases to the detriment of taxpayer without issuing a rule. Taxpayer asserts that Sales Tax Information Bulletin #8 issued in 1990 changes the Department's treatment of the law concerning the taxability of software purchases from the treatment of software purchases issued in the 1983 Sales Tax Information Bulletin #8.

However, the statutory language in IC 6-8.1-3-3 does not apply to the Department's treatment of software in this case. IC 6-8.1-3-3(b) states the following:

No change in the Department's interpretation of a listed tax may take effect *before the date* the change is:

- (1) adopted in a rule under this section; or
- (2) published in the Indiana Register if the interpretation is not required to be adopted as a rule.

if the change would increase a taxpayer's liability for a listed tax.

Emphasis added.

This statute applies only to interpretations made by the Department regarding listed taxes that are either adopted in a rule or published in the Indiana Register. With respect to rules and publications in the Indiana Register, this statute simply provides that no change in the Department's interpretation of a listed tax may take effect *before the date* the change is adopted as a rule or published in the Indiana Register. This is a notice provision regarding the Department's changes in rules and publications. With regard to the taxability of computer software and computer licensing agreements, the Department has not changed an "interpretation of a listed tax" adopted in a rule or published in the Indiana Register.

Moreover, in this case, the Department finds that computer software purchases are subject to tax because the sale, lease, rental, or purchase of a license for software, involves the transfer of tangible personal property for consideration. IC 6-2.5-4-1. Thus, the taxpayer acquired computer software in a retail transaction upon which no sales tax was paid. Therefore, the taxpayer's purchase is subject to use tax imposed on the use of tangible personal property acquired in a retail transaction.

FINDING

Taxpayer's protest is denied.

III. Tax Administration: Negligence Penalty

DISCUSSION

Taxpayer was assessed a negligence penalty for failure to remit use tax to the Department. Taxpayer argues that this deficiency was due to reasonable cause. The taxpayer took prudent care in establishing a use tax accrual system to self-assess tax on taxable purchases. This effort, among other factors, demonstrates that the taxpayer exercised ordinary business care and prudence in carrying out its duty to remit use tax on its taxable purchases.

FINDING

Taxpayer's protest is sustained.